Teachers' Pension Plan Board
Conseil du régime de retraite des enseignantes et des enseignants
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EXCHANGE

A NEWSLETTER FOR MEMBERS OF THE ONTARIO TEACHERS' PENSION PLAN

How we invest in stocks
and how we came to own shares of Bre-X

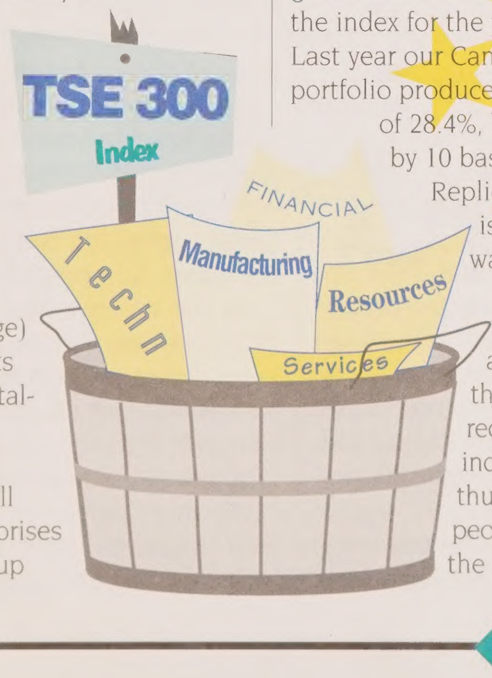
Our investment performance is measured by the fund's rate of return. So winning on individual investments is important, but how well the overall fund performs is critical.

In the aftermath of the Bre-X fraud, many teachers have shown an interest in understanding how we choose investments. In this issue of Exchange *we explain the methods we use to invest in stocks, why they work and how we came to own shares of the now infamous Bre-X Minerals.*

We buy stocks in two ways: 1. We buy a basket of stocks that mimics the market index. 2. We select individual stocks we think are undervalued.

1. HOW WE MIMIC THE MARKET

The TSE 300 index contains shares of Canada's 300 major public corporations. We buy the market by investing proportionately in every stock listed on the TSE (Toronto Stock Exchange) 300 index to its weighted capitalization in the index. For instance, if Bell Canada Enterprises (BCE) makes up 5.02% of the index, then 5.02% of our Canadian index portfolio contains BCE shares.



Investing this way may seem like a 'no brainer,' but successful portfolio managers can earn additional value. Through astute trading, our index portfolio has generated returns in excess of the index for the past four years. Last year our Canadian index portfolio produced a rate of return of 28.4%, beating the index by 10 basis points.

Replicating the index is a cost-effective way to invest. Because we are buying all the stocks in the index, we do not require analysis of individual stocks, and thus we need fewer people to manage the portfolio.

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IMPROVED STATEMENTS OUT THIS FALL

Your next annual statement will look different, the result of an improved method of calculating your pension credit that will make pension calculations more accurate and fair.

Your statement will incorporate two important changes:

- service will be reported on a school-year basis rather than a calendar-year basis;
- credit calculations will be based on the percentage of the school year actually worked.

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HAVE *Your* SAY...

COMMUTED VALUE ESTIMATES SOONER

"I need to get very accurate commuted value to a specific date. Can this be done?"

L. H., London

Commuted value estimates are valid for 30 days. They're calculated using the yield on real-rate return Government of Canada bonds. This is a monthly figure prescribed by the Canadian Institute of Actuaries for commuted value calculations. The yield on real-rate return bonds is widely regarded as the market's current expectation of long-term real rates of return. Interest rates change monthly.

The *Pension Benefits Act* requires us to use the institute's recommendations to estimate a commuted value.

REVENUE CANADA RULE ON DEFERRED LEAVES

"After returning to work from a one-year deferred salary leave (in this case, 4/5) for 70 days, can my wife resign her position, begin her pension and not be subject to any further taxes under Revenue Canada rulings."

B. T., Dundas

According to the plan, your wife needs to return to work for at least 70 days. However, Revenue Canada requires that she return to work for a time at least equal to the leave, in this case one year, to receive preferential tax treatment. So, your wife can resign and begin to collect her pension, but Revenue Canada may reassess her income tax returns for the last five tax years and she may find herself with a substantial tax bill. It's a good idea to check with Revenue Canada or a tax accountant.

Deferred salary leaves are exempt from the benefit changes that took effect January 1, 1997, (please see Winter 1997 special edition of *Exchange*). If you're five years from your earliest unreduced retirement date, you can take a leave of absence and buy the credit for your time away without the 70-day return to work requirement. The leave must begin between January 1, 1997, and December 31, 1999, and payment must be made during your leave. This change does not cover deferred or x/y salary leaves.

What is a BENCHMARK?

The benchmark is a market or industry standard. Each portfolio is measured against a benchmark that tracks the average results of the market in which we invest. To the extent we exceed market averages, we can identify the value we have added to each portfolio. The benchmarks used include:

- TSE 300 for Canadian equities
- Standard & Poor (S&P) 500 for U.S. equities
- EAFE index for equities in Europe, Australia and the Far East
- Frank Russell Canada Property Index for real estate
- Scotia McLeod Canada bond index for bonds

We measure the performance of the total fund against a composite benchmark that aggregates the returns for each portfolio benchmark, using our asset mix policy weights.

Last year the pension plan achieved a 19% rate of return, beating the composite benchmark of 18.1%.

Business and industry

WERE YOU ADMITTED TO THE OCE TWO-SUMMER PROGRAM IN 1969?

If you were admitted to the Ontario College of Education's (OCE) two-summer program at the University of Toronto in 1969, you may now be eligible to have your prior business and industry experience recognized by the Teachers' Pension Plan.

To qualify you must have been admitted to the OCE two-summer program at U of T in 1969 based on your business and industry experience and received an Interim High School Assistant's (HSA) Certificate, Type B. If you meet these two conditions, please contact one of our customer service specialists for more information.

An Ontario court recently found that OCE graduates admitted in 1969 to the two-summer program at U of T had not been notified of an administrative change in 1991. This change would have permitted these OCE graduates to buy credit in the pension plan for their experience in business and industry before they began teaching.

How we invest in stocks

and how we came to own shares of Bre-X

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Our strategy of replicating the index is a significant reason why our investment expenses are low. Last year we spent 8.6 cents for every $100 of invested assets, while the average pension plan spent 16 cents and the average equity mutual fund $2.

WHY BUYING THE BASKET OF STOCKS WORKS

The performance of index funds has historically proven effective over the long term. According to the December 1996 edition of the *Financial Post Survey of Mutual Funds*, the annualized return of the index exceeded the average Canadian mutual fund in seven of the last 10 years, before management fees.

The chart below shows the growth of the index during the past 30 years. The average annual rate of return for the last 20 years was 13.76%. Eliminating the effect of inflation, this means that if you took $1,000 in 1977 and invested it in the TSE 300 index, today you would have $13,187.

Replicating the index is also one of the primary ways we buy stocks on the American, European and Far East markets.

Canadian index funds at a glance*

Portfolio:	Core Domestic
Investments:	$13.8 billion
Contains:	300 companies listed on the TSE 300
Rate of return:	28.4%
Benchmark:	28.3% (TSE 300)
Goal:	Match the performance of the index

2. SELECTING INDIVIDUAL STOCKS

We also select shares of individual companies we consider to be undervalued. We analyze each company's financial performance, operations, industry position, management quality, long-term business plan, board structure and board independence.

The most important principle behind this investment approach is that we look for value. This work is done by staff teams of portfolio managers and stock analysts.

> "The return on an individual stock is less important than the return on the portfolio."
>
> *Claude Lamoureux, President and CEO*

It can take several years for the market to recognize the value of a company's shares, hence the patience of our long-term approach. When gains materialize, we do take profits, although we may not necessarily sell our entire position in a company.

In 1996, the actively managed Canadian stock portfolio produced a 31.5% rate of return, compared with the benchmark of 28.3%.

Canadian actively managed equities at a glance*

Portfolio:	Equities
Investments:	$2.7 billion
Contains:	about 40 companies
Rate of return:	31.5%
Benchmark:	28.3% (TSE 300)
Goal:	Create value in excess of TSE 300

* at December 31, 1996

EFFECT OF BRE-X FRAUD

Our investment in Bre-X was made through our index fund after the Toronto Stock Exchange added it to the TSE 300 index.

- Bre-X was added to the TSE 300 index in November 1996.
- We purchased 4.4 million shares at a cost of about $100 million, or less than 0.2% of the total fund.
- The loss amounts to 20 cents out of $100.
- We have asked the TSE to review the process used to add stocks to the index, and we are re-evaluating our own processes as well.

ASSET MIX IS CRITICAL

Buying the stocks listed on the index, or selecting the individual stocks we think will be winners are important to the performance of the fund. However, the dominant determinate of a fund's long-term performance is its asset mix.

"More than 80% of value creation is derived from establishing a long-term asset mix appropriate to the liabilities of the fund," says Leo de Bever, the pension plan's vice-president of Research and Economics. The fund's asset mix is 75% equities (stocks, private companies and real estate) and 25% fixed income (government debentures, treasury bills, mortgages).

HIGHLIGHTS OF OUR 1996 INVESTMENT PERFORMANCE

- Total assets grew by $9 billion to almost $51 billion.
- The rate of return on investments was 19%.
- The rate of return for the last four years averaged 14.6%, one of the best results of any pension plan or balanced mutual fund.
- The fund achieved a surplus of $1.2 billion, a welcome change from the deficiency of $3.6 billion in 1990 when the board was created.

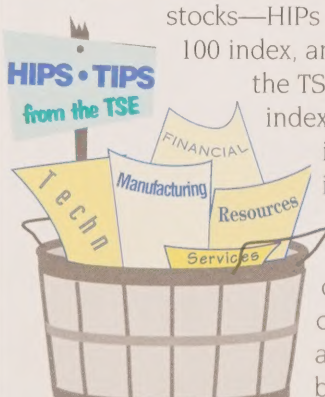
ROLE OF THE BOARD OF DIRECTORS

The board of directors approves and monitors each of our investment programs. For index funds the investment program is straightforward—if a stock is in the index, we buy it.

The nine directors oversee the operations of the Teachers' Pension Plan. Four of the directors are appointed by the OTF and four by the Ontario government. The ninth member, the chair, is jointly appointed.

HERE'S HOW YOU CAN BUY A BASKET OF STOCKS

If you're interested in long-term investing and like the idea of index funds, you can buy units of HIPs or TIPs. These trade like stocks on the Toronto Stock Exchange but are representative of a basket of stocks—HIPs is the TSE 100 index, and TIPs is the TSE 35 index. If you're interested in buying units of HIPs or TIPs, contact a stock broker.



DUDLEY DOOMSAYER

"The surplus will mean we all get larger pensions. Right?"

CONSIDER THIS:

- Your teachers' pension is a defined benefit plan which means the amount of your pension is determined by your years of service and your average best-five years' salary. It is important to the fund that our investments do well, but healthy returns do not mean larger individual pensions.
- A surplus acts as a cushion against volatile capital markets.
- Stock markets have performed extremely well over the past seven years. However, a major correction, which normally occurs every five years, could temporarily reduce asset values by several billions of dollars while liabilities could continue to rise. This makes the cushion of the surplus important.

Improvements made to annual statements

Continued from page 1

The new-look statements will be mailed to you this autumn.

The move to reporting on a school-year basis more accurately reflects the reality of how you are employed and the terms under which you work.

The other major change—capturing the percentage of time actually worked in a school year—will also improve accuracy and fairly portray your credit in the plan and the benefits you can expect from it.

Previously, credit was calculated on the assumption that you worked a 200-day year. In fact, your school year is subject to many variables and may be longer or shorter than 200 days. The old system wasn't accurately reflecting the reality of a changed—and changing—work-place.

The shift to a calculation based on the percentage of the school year worked means eight out of 10 teachers will either see no change, or a slight increase to their total credit. Any adjustments to credit will be minimal.

Watch for your NEW Annual Statement

STATEMENT CHANGES

	NEW	PREVIOUS
Reporting period	School-year basis (September to August)	Calendar-year basis (January to December)
Credit recorded on your annual statement	Presented as a proportion of each year worked	Presented as years, months and days on a set 200 days per year

ESTIMATING YOUR FUTURE PENSION

Projecting your date of retirement has always involved building assumptions into the calculations. One major assumption in the past was that a teacher taught full time. With recent changes, assumptions like that need to be examined carefully. Many factors can change those assumptions: teaching part time, moving from teaching staff to administration, leaves of absences and so on. The new approach is designed to better accommodate these variables.

To ensure those members closest to retirement are able to make plans, the data in their files will be reviewed first, using the new approach to calculations. Under the new design, projected retirement dates will be calculated based on school calendars under the *Education Act* regulations. There will still be variables in the calculations, including the fact that some boards of education may have school years that do not exactly match the ministry's school calendar. But in all cases, we will project retirement dates based on the best information available and continue to update that information through the course of your career.

Improving the accuracy and timeliness of our data is an ongoing process. The Teachers' Pension Plan is a leader in the development of new and better systems to serve you. We are committed to the continuous improvement of our systems and our service to members, and will communicate these changes to you as they are implemented.

PILOT PROJECT PROVIDES MORE TIMELY STATEMENTS

About 15,000 teachers will receive an annual statement of their benefits to August 31, 1997—the most timely ever. These teachers work for one of 17 school boards involved in a pilot project where credit and salary information is reported to us every month. Eventually, we hope to have every school board provide data to us using the new, more frequent system of reporting.

Most school boards still report the data on a yearly basis which means information about your teaching from January to December 1996 isn't communicated to us until the spring of 1997. That's why many of you will receive statements of your benefits accumulated to August 31, 1996.

REAL-LIFE RETIREMENT

The latest in a series featuring retired teachers who have found fulfilling ways to enjoy their retirement.

Retired elementary school principal Mike Heptinstall and his wife Jackie recently returned from two years in Uganda. Mike taught at a teachers' college while Jackie volunteered at a mother and child immunization clinic. Mike poses with some neighbors in the village where they lived. Mike and Jackie live in Aurora.

Photo by Jackie Heptinstall

EXCHANGE

is a publication prepared by the Ontario Teachers' Pension Plan Board. We welcome your comments and suggestions. Feel free to call John Cappelletti at (416) 730-5351 or 1-800-668-0105, or fax at (416) 730-5346 or write to:

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MOVING?

DON'T FORGET TO SEND US YOUR NEW ADDRESS

All our publications are sent to you at your home address, including information of personal interest to you, such as your annual statement of benefits.
If we don't know where you are, we can't reach you!

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